July 1990 Monthly Survey August 9, 1990

# Surveys of Consumers

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## PROSPECTS FOR ECONOMY DIM IN JULY SURVEY SENTIMENT VULNERABLE TO FURTHER DECLINES

### Potential Impact From Middle East Crisis

The July 1990 survey reflects conditions prior to the recent developments in the Middle East. To be sure, these developments are likely to have an immediate and negative impact on consumer sentiment. What is not as clear is how deep and how lasting the decline will be.

The immediate increase in gasoline prices acted to translate distant problems into hometown concerns, and changes in global markets into concerns about family budgets. Unlike the stock market crash of 1987, where only a minority of consumers were shareholders, nearly all consumers sense a direct economic stake in the current crisis.

Like the stock market crash of 1987, the initial reaction of consumers is more likely to be a heightened sense of uncertainty about the future rather than outright pessimism. The developments in the weeks to come will play an important role in forming the responses of consumers to this crisis. The high levels of uncertainty caused by the 1987 stock market crash quickly dissipated. The same could happen in the current situation, if events warrant.

To be sure, the current crisis comes at a time when consumer confidence is already weakened, and may act to reinforce and accelerate that downward momentum. Moreover, the recent developments focus directly on the several areas of strength in the current data, in particular personal finances and the easing of concerns with inflation and interest rates.

### Index Unchanged At Lower Level

Consumer confidence remained unchanged in the July survey at the depressed June level. Among all families, the Index of Consumer Sentiment was 88.2 in July, just below the 88.3 recorded one month earlier, but significantly below the 92.0 one year earlier. Excluding the two months following the 1987 stock market crash, the current level of consumer confidence is the lowest since the expansion began.

Although the overall level of confidence remained unchanged in July, among lower income families it improved, while among higher income families it declined. Among families with incomes of $40,000 or more, the Index fell to 94.4 in July from 99.1 in June and 101.9 in July 1989.

### Significant Regional Differences in Confidence

In the July survey, sentiment remained the lowest among residents of the Northeast (82.6) and South (85.3), while the sentiment index was significantly higher among residents of the West (90.1) and North Central (93.3) regions. Since the Spring of 1990, those living in the Northeast and South have voiced the lowest levels of consumer confidence since the start of the current expansion.

The weakness in the Northeast has been present since the start of the year, with no further declines recorded during the past three months. The decline

in sentiment among the residents of the South has been more recent, with the Index falling from 100.1 in April to 85.3 in July. Although sentiment among Western residents remains at a favorable level, it too has suffered a significant loss in recent months, declining from 101.1 in April to 90.1 in July. In contrast, among residents of the North Central region sentiment has declined by only a minor amount, falling to 93.3 in July from 95.6 three months earlier.

**Leading Indicator Posts Small Gain But Remains Low**

The Index of Consumer Expectation, the component of the Index of Leading Indicators, rose slightly to 77.3 in the July 1990 survey from 76.6 one month earlier, but was significantly below the year-earlier figure of 85.5. Even with this small rebound, the Expectations Index was lower during the past two months than in any prior survey during the current expansion except for the brief dip following the 1987 stock market crash. At present, the Expectations Index is 20 Index-points below the 1984 cyclical peak, and 30 Index-points above the last cyclical low point.

**Concerns Heighten Over Prospects for Economy**

For the first time since the expansion began (again excluding the brief dip following the 1987 stock market crash), the balance of opinion among consumers pointed toward an unfavorable outlook for the general economy during the year ahead. Among all families in the July 1990 survey, 42 percent expected bad times financially in the economy as a whole, compared with 40 percent that expected good times financially. One year ago, nearly twice as many consumers expected good rather than bad times financially (53 versus 29 percent).

Longer term prospects for the economy were also viewed negatively. In the July 1990 survey, 50 percent of all families reporting that they expected bad times financially in the economy as a whole during the next five years, up from 43 percent one year ago.

The major concern with prospects for the general economy involve increases in unemployment. Among all families in the July 1990 survey, 37 percent expected the national unemployment rate to increase during the year ahead, compare with just 7 percent that expected declines in unemployment.

**Inflation and Interest Rates Post Small Improvements**

Small improvements were recorded in inflation and interest rate expectations. Consumers expected the annual rate of inflation to average 4.7% during the year ahead in the July survey, down from 4.9% one month earlier and 5.1% one year earlier. Interest rate expectations continued on their slow path of improvement, with increases expected by 50 percent of all families in July, down from 56 percent in June.

**Personal Finances Remain Positive**

The proportion of American families that reported that their financial situation had improved stood at 43 percent in the July survey, unchanged from one and two months earlier. However, the proportion that reported that their financial situation had worsened rose to 28 percent in July from 24 percent in the prior two months. In explaining the changes in their financial situation, fewer families reported income gains in July than in the June survey (32, down from 34 percent), and reports of income declines rose (13, up from 11 percent).

Consumers continued to judge their financial prospects for the year ahead in favorable terms. Among all families, 37 percent expected their financial situation to improve during the year ahead, just above the 36 percent recorded one month earlier and the 35 percent recorded one year earlier. Importantly, just 10 percent of all families expected their financially situation to worsen during the year ahead in the July survey. Most families (51 percent) expected little if any change in their overall financial

situation, considering trends in both their incomes and prices.

**Buying Conditions**

Attitudes toward buying conditions remained at generally favorable levels in the July 1990 survey. These favorable attitudes are dependent to a greater extent than in any prior expansion on the availability of discounted prices. Without price discounts, consumers are ready and willing shop elsewhere or to postpone purchases until they are again offered.

Durables. Favorable attitudes toward buying conditions for furniture, appliances, and other large household durables were held by 73 percent of all families in the July 1990 survey, just between the 75 percent recorded one month earlier and the 71 percent recorded one year earlier. These favorable attitudes were predicated by the view that discounted prices would be available. Among all families in the July 1990 survey, 37 percent referred the availability of discounted prices, up from 31 percent both one month and one year earlier.

Vehicles. Favorable attitudes toward buying conditions for vehicles were held by 65 percent of all families in the July 1990 survey, just ahead of the 63 percent recorded one month earlier and the 64 percent recorded one year earlier. In explaining their views, 41 percent of all respondents mentioned the availability of price discounts in the July 1990 survey, unchanged from one and two months earlier.

Homes. Favorable attitudes toward buying conditions for homes were held by 66 percent of all families in the July 1990 survey, just ahead of the 65 percent recorded one month earlier and the 64 percent recorded one year earlier. Lower home prices continue to be the dominant reason given by consumers for these favorable views of home buying conditions. In the July 1990 survey, 29 percent mentioned lower home prices when asked to explain their view, tieing the all-time peak first recorded in the Spring of 1990.

That home prices are lower is certainly seen as an advantage for the buyer. Most home buyers, however, are also home sellers, and the price declines also represent a disadvantage. Indeed, when answering this question some respondents specifically qualified their views by the caveat: "Its a good time to buy, but not to sell." Since the question asks about buying conditions, the overall favorable level is likely to overstate market activity.

It has been suggested that a decline in the value of both the home they own and the one they wish to purchase would leave home buyers in an unchanged situation. While the economic equivalence may hold, there is little reason to expect an equivalence on a psychological basis. The importance attached to the decline in the value of their current home is much greater than the weight given to price declines in homes they might purchase.

This situation is somewhat similar to consumer reactions to COLA adjusted incomes: the income gains were often viewed as justified by individual effort and the price increases viewed as unwarranted dilutions of these hard won gains.

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The July 1990 survey included 500 completed interviews conducted between July 1 and July 27, 1990.